



# Parker-Hannifin Corporation (PH)

Updated November 12<sup>th</sup>, 2019 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$199	<b>5 Year CAGR Estimate:</b>	4.4%	<b>Volatility Percentile:</b>	67.3%
<b>Fair Value Price:</b>	\$158	<b>5 Year Growth Estimate:</b>	7.5%	<b>Momentum Percentile:</b>	59.4%
<b>% Fair Value:</b>	126%	<b>5 Year Valuation Multiple Estimate:</b>	-4.6%	<b>Growth Percentile:</b>	78.7%
<b>Dividend Yield:</b>	1.8%	<b>5 Year Price Target</b>	\$226	<b>Valuation Percentile:</b>	31.8%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	34.1%

## Overview & Current Events

Parker-Hannifin is a diversified industrial manufacturer specializing in motion and control technologies. The company was founded in 1917 and has grown to a market capitalization of \$26 billion with annual revenues of \$14 billion. Parker-Hannifin has paid a dividend for 69 years and has increased that dividend for a remarkable 63 consecutive years.

In late October, Parker-Hannifin reported (10/31/19) financial results for the first quarter of fiscal 2020. Sales and organic sales decreased -4% and -3%, respectively, due to soft demand in North America and international markets. The company posted an almost record adjusted operating margin of 17.3% and record operating cash flows of \$449 million but its adjusted earnings-per-share fell from \$2.84 in last year's quarter to \$2.76.

On October 29<sup>th</sup>, Parker-Hannifin completed the acquisition of LORD, a leading manufacturer of advanced adhesives and coatings, for \$3.675 billion in cash. On September 16<sup>th</sup>, Parker-Hannifin completed the acquisition of Exotic Metals Forming Company LLC for \$1.725 billion in cash. These two acquisitions are expected to add \$1.5 billion in annual revenues. On the other hand, management provided disappointing guidance for a second consecutive quarter due to softening demand for its products. It lowered its guidance for this fiscal year's adjusted earnings-per-share from \$11.50-\$12.30 to \$10.10-\$10.90. This guidance is in sharp contrast to its guidance until six months ago for at least 10% annual earnings-per-share growth until 2023. We have lowered our earnings-per-share forecast for this fiscal year from \$12.00 to \$10.50. Notably Parker-Hannifin has exceeded analysts' earnings-per-share estimates for 17 consecutive quarters.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$3.40	\$6.37	\$7.45	\$6.26	\$6.45	\$7.25	\$6.46	\$8.11	\$10.42	\$11.85	<b>\$10.50</b>	<b>\$15.07</b>
<b>DPS</b>	\$1.01	\$1.25	\$1.54	\$1.70	\$1.86	\$2.37	\$2.52	\$2.58	\$2.81	\$3.16	<b>\$3.52</b>	<b>\$4.80</b>
<b>Shares<sup>1</sup></b>	161.3	155.1	149.6	149.3	148.8	138.4	134.0	133.1	132.4	128.5	<b>126.0</b>	<b>115.0</b>

During the last decade, Parker-Hannifin has more than tripled its earnings-per-share. While the company cannot maintain this growth rate in the upcoming years, it still has exciting growth prospects ahead. Nevertheless, due to deceleration in North America and international markets, we expect approximately 7.5% annual earnings-per-share growth over the next five years.

Parker-Hannifin's growth will come in part from acquisitions. The \$4.3 billion CLARCOR transaction and the aforementioned two acquisitions are examples of this. Parker Hannifin integrates the new products in its system while it achieves significant synergies.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2025
<b>Avg. P/E</b>	14.5	16.7	12.6	10.8	13.9	18.0	16.6	16.3	17.3	14.2	<b>19.0</b>	<b>15.0</b>
<b>Avg. Yld.</b>	2.2%	1.8%	1.6%	1.9%	2.0%	1.6%	2.0%	2.4%	1.8%	1.9%	<b>1.8%</b>	<b>2.1%</b>

<sup>1</sup> In millions.

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Parker-Hannifin has rallied 31% in about six months and is currently trading at a price-to-earnings ratio of 19.0, which is much higher than our fair value estimate of 15.0 and the richest valuation level in more than a decade. If the stock reverts to our fair value estimate over the next five years, it will incur a -4.6% annualized drag in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29.7%	19.6%	20.7%	27.2%	28.8%	32.7%	39.0%	31.8%	27.0%	26.7%	33.5%	31.8%

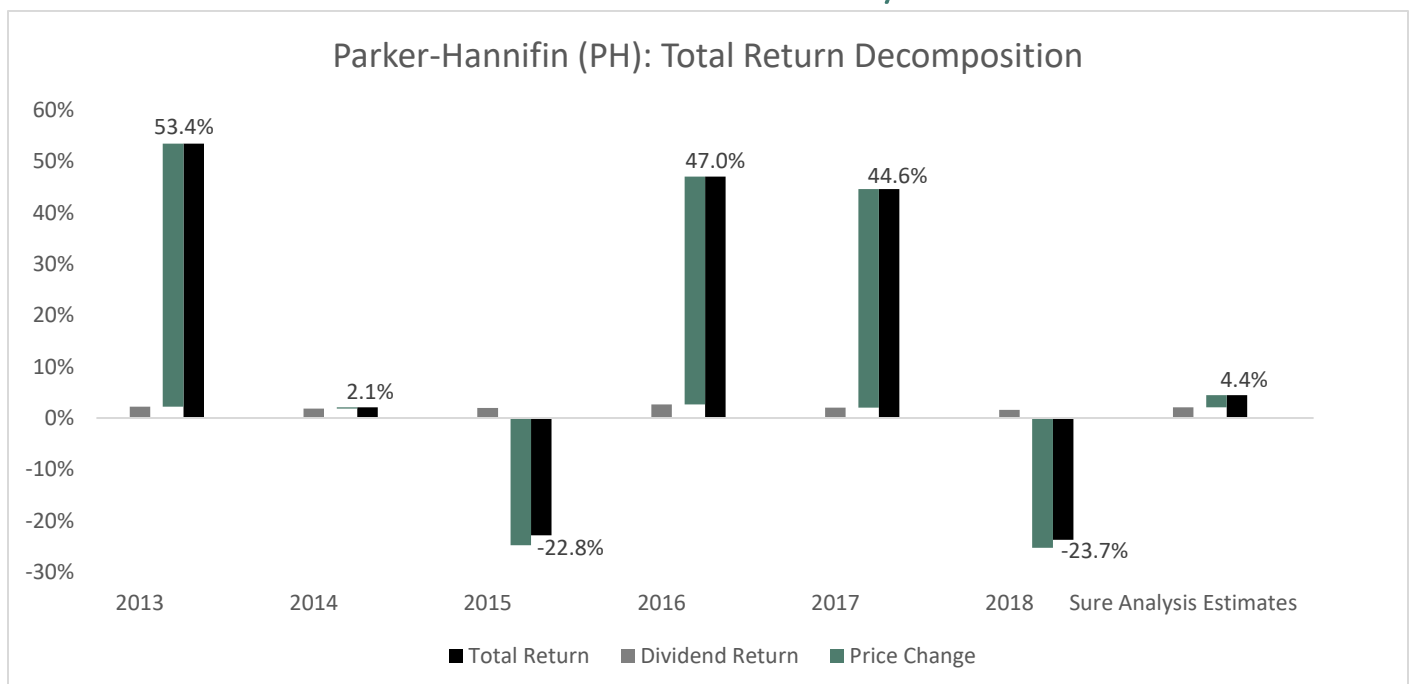
Parker-Hannifin has a number of competitive advantages, including its scale, global distribution network, and technical experience. Parker-Hannifin manufactures components that are relatively obscure yet absolutely critical to the operations of heavy machinery, factory equipment, aircrafts, and other large industrial devices. This is appealing because the company operates in a profitable niche that helps discourage large would-be competitors. The competitive advantage of Parker-Hannifin is clearly reflected in its dividend growth record, which is exceptional, particularly given the high cyclicality of the industrial sector. The company raised its dividend by 16% this year and it has now raised its dividend for 63 consecutive years.

Due to the recent acquisitions of Parker Hannifin, its interest expense has increased more than 50%. However, its interest expense still consumes only 10% of its operating income. In addition, thanks to its strong free cash flows, Parker-Hannifin will reduce its interest expense at a fast clip, just like it has done after past acquisitions. The decrease in interest expense will provide an additional (though modest) boost to the bottom line.

## Final Thoughts & Recommendation

Parker-Hannifin has rallied 31% in less than six months and has exciting growth potential in the years ahead. However, growth has decelerated while the stock is trading at a decade-high valuation level. As a result, the stock has become much less attractive than it was a few months ago. We now expect the stock to offer just a 4.4% average annual return over the next five years and thus we lower its rating from “buy” to “hold”.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	10309	9993	12346	13146	13016	13216	12712	11361	12029	14302
Gross Profit	2128	2146	2958	3188	2929	3028	3056	2537	2840	3540
Gross Margin	20.6%	21.5%	24.0%	24.2%	22.5%	22.9%	24.0%	22.3%	23.6%	24.7%
SG&A Exp.	1290	1277	1468	1519	1555	1634	1545	1359	1454	1657
D&A Exp.	358	363	340	322	336	337	317	307	355	466
Operating Profit	837	869	1491	1668	1374	1394	1512	1178	1386	1882
Op. Margin	8.1%	8.7%	12.1%	12.7%	10.6%	10.5%	11.9%	10.4%	11.5%	13.2%
Net Profit	509	554	1049	1152	948	1041	1012	807	983	1061
Net Margin	4.9%	5.5%	8.5%	8.8%	7.3%	7.9%	8.0%	7.1%	8.2%	7.4%
Free Cash Flow	858	1090	960	1312	925	1172	1148	1061	1099	1353
Income Tax	173	198	357	421	362	515	420	308	345	641

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	9856	9910	10887	11170	12541	13274	12279	12034	15490	15320
Cash & Equivalents	188	576	657	838	1781	1614	1181	1222	885	822
Accounts Receivable	1417	1443	1770	1782	1841	1858	1620	1594	1931	2146
Inventories	1255	1172	1412	1401	1377	1372	1300	1173	1549	1621
Goodwill & Int. Ass.	4177	3936	4187	4021	4514	4360	3956	3826	7894	7520
Total Liabilities	5505	5451	5398	6265	6799	6612	7172	7455	10223	9455
Accounts Payable	650	889	1174	1195	1156	1252	1092	1035	1300	1430
Long-Term Debt	2321	1777	1766	1730	2830	2325	2947	3014	5870	4957
Shareholder's Equity	4268	4368	5384	4897	5738	6659	5104	4575	5262	5860
D/E Ratio	0.54	0.41	0.33	0.35	0.49	0.35	0.58	0.66	1.12	0.85

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	5.0%	5.6%	10.1%	10.4%	8.0%	8.1%	7.9%	6.6%	7.1%	6.9%
Return on Equity	10.7%	12.8%	21.5%	22.4%	17.8%	16.8%	17.2%	16.7%	20.0%	19.1%
ROIC	7.3%	8.6%	15.6%	16.6%	12.5%	11.9%	11.9%	10.3%	10.5%	9.7%
Shares Out.	160.5	161.3	155.1	149.6	149.3	148.8	138.4	134.0	133.1	132.4
Revenue/Share	63.35	61.34	74.92	85.00	85.86	87.27	87.60	82.98	88.74	105.61
FCF/Share	5.28	6.69	5.82	8.48	6.10	7.74	7.91	7.75	8.11	9.99

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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